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Supreme Court of the United States

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CHARLES SCHUSTERMAN AND
LYNN N. SCHUSTERMAN,

Petitioners

vs.

UNITED STATES OF AMERICA,

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITIONERS' REPLY BRIEF TO THE BRIEF OF THE UNITED STATES IN OPPOSITION

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RESPONDENT'S BRIEF IN OPPOSITION DODGES THE FUNDAMENTAL QUESTIONS RAISED BY PETITIONERS, AND FALSELY CONCLUDES THAT THIS CASE DOES NOT INVOLVE AN ISSUE OF CONTINUING IMPORTANCE.

Petitioners respectfully submit that the Brief for the United States in Opposition is disingenuous in its effort to persuade the Court that it should deny the Petition for a Writ of Certiorari. The Unites States ("Respondent") acknowledges that there is confusion about the correct statutory construction of section 483[1] and a conflict among the courts of appeal, but suggests that the conflict is based on an "old" statutory provision that has been amended and replaced with a new set of "time-value-of-money" rules in section 1274 that flawlessly eliminate the confusion. That is simply incorrect, as are other misstatements in Respondent's Brief. Those misstatements should be answered lest Petitioners' silence be construed as acquiescence that Respondent has unerringly found the Achilles' Heel in Petitioners' arguments.

- The disagreement between the courts of appeal is over the proper construction of the phrase "for purposes of this title", which is crucial to the continuing interpretation of the Internal Revenue Code. Respondent takes notice of the fact that section 483 is applicable "for purposes of this title", which includes *inter alia,* both subtitle A (the income tax) and subtitle B (the gift tax),[2] but provides no answer to Petitioners' contention that those words have pervasive meaning that cannot, and should not, be ignored in the absence of some unambiguous directive elsewhere in the statute or the legislative history. There is none! To the contrary, Congress has chosen to use the words "for

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[1] All references are to Title 26 of the United States Code (the Internal Revenue Code), except where otherwise indicated.

[2] Respondent's Br. at p. 10.

purposes of this title" no less than 90 times in the Internal Revenue Code, and it clearly understands the meaning of the phrase.[3] Respondent ignores the importance of construing consistently the phrase "for purposes of this title". Instead, Respondent's only rebuttal is to rehash the opinion of the court below which, we submit, likewise ducked the real issue of statutory construction. By paying lip service to and then disregarding the phrase "for purposes of this title", the court below violated one of the cardinal principles of statutory construction and in the process destroyed the intricate relationship between section 483 and other sections of the Internal Revenue Code.[4]

- Respondent would have the Court believe that the Internal Revenue Service actually "valued" the installment notes received by Petitioners from their childrens' trusts for gift tax purposes, but this is a mischaracterization. Instead, the Internal Revenue Service merely substituted a higher interest rate than the "safe harbor" rate specified in section 483 for the purpose of discounting the installment notes to determine their alleged present value under the gift tax. That is precisely what section 483 was designed to prevent "for purposes of this title."[5]
- Most importantly, Respondent states that "[t]he issue presented in this case has little continuing significance to the administration of the tax laws due to the enactment of section 1274(d) of the Internal Revenue Code in the Tax Reform Act of 1984 [citation omitted]."[6] Therefore, Respondent says, "[t]he question presented in this case is

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[3] Petition at pp. 10-11.

[4] Petition at p. 23 *et seq.*

[5] Petition at p. 15.

[6] Respondent's Br. at p. 13.

thus of little continuing importance and does not warrant this Court's review."[7] This is demonstrably wrong. Section 483(e), as well as sections 1274 (c) (3) and (4) and 1274A, all provide fixed "safe harbor" interest rates that differ substantially from the floating APR rate imposed for general application. Consequently, the issue before the court is alive and well today, and any taxpayer that relies on one of these statutory "safe harbor" rates in making an intra-family sale will do so at his or her own risk if Respondent's position prevails. A prime example of that risk is the decision of the Tax Court in *Frazee v. Commissioner,*[8] which emasculated section 483(e) and subverted the clear will of Congress. Although Respondent urges that this case is not an appropriate vehicle for review of section 483(e) because this case did not involve a sale of land, *we hasten to point out that the purpose and language of the "safe harbor" rates in sections 483(a) and 483(e) are identical,* so the decision of the court below validates an ongoing trap for the unwary taxpayer.[9] Respondent waited until the last sentence in the last footnote of its Brief to signal clearly that the Internal Revenue Service will attack under the gift tax intra-family sales of land that fall squarely under the protection of sec-

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[7] Respondent's Br. at p. 14.

[8] 96 T.C. 554 (1992), discussed in Petition at p. 21.

[9] This is equally true of the "safe harbor" rates in sections 1174(c)(3) and (4) and 1274A. Even more diabolical, there is typically a spread between the AFR and the prevailing prime interest rate at any point in time, and if the value of the intra-family sale was great enough, there is nothing explicit in section 1274(d) that would preclude the Internal Revenue Service from seeking to impose a gift tax under section 2512 based on that spread; (though Respondent apparently concedes in its brief that it would not elect to do so).

tion 483.[10] Delaying the resolution of the proper construction of the phrase "for purposes of this title," as well as the other issues in this case, will only perpetuate taxpayers' confusion and engender further litigation with the Internal Revenue Service.

- Furthermore, by suggesting that this case has "little continuing significance", Respondent also blithely dismisses as having little importance the proper construction of the phrase "for purposes of this title" (or variations thereof, such as "for purposes of this subtitle"), which Congress uses repeatedly to expand or limit the scope of particular provisions in the Internal Revenue Code. We cannot stress too much how important it is for tax compliance and proper tax administration for the Court to restore confidence in the unambiguous meaning of this key phrase.

- Respondent dismisses Petitioners' reference to regulations proposed by the Treasury Department on April 8, 1986,[11] which explicitly construe section 483 as governing valuations under section 2512 of the gift tax, on the grounds that they have never been adopted in final form and, therefore, are without legal significance.[12] Once again, that misses our point about a principle of statutory construction that precludes the courts from tinkering with unambiguous statutory language. We do not rely on the proposed regulations as substantive authority, but we do believe it is informative that a deliberative administrative process construed the words "for purposes of this title" in precisely the

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[10] The last sentence of fn. 5 reads as follows: "In any event, there is no reason to believe that the test rate applicable under section 483(e), any more than the section 483(a) test rate petitioners used, was intended to be used for gift tax purposes."

[11] Petition at pp. 13-14.

[12] Respondent's Br. at fn. 4.

same way urged by Petitioners. Furthermore, Respondent cites an IRS General Counsel Memorandum that reaches a conclusion contrary to the proposed regulations and ostensibly represents the government's "litigating position."[13] It is indisputable that in the hierarchy of administrative pronouncements proposed regulations would trump a General Counsel Memorandum. Therefore, one might legitimately ask why after 10 years the proposed regulations have never been withdrawn? The reality is that Respondent is litigating against one of its own public pronouncements.

- Finally, Respondent suggests that Petitioners' plight was of their own making, because they had the unequivocal right to report the transaction in the year of sale (rather than on the installment method) by valuing the installment notes at their alleged discounted fair market value (not the face amount).[14] In the first place, the taxes associated with that decision would have been so horrendous that it most certainly was not a practical option. As we pointed out, reporting the transaction in the year of sale at the alleged discounted value of the installment notes would not have reduced by one penny the amount of income to be reported by Petitioners, but would have exacerbated the problem by transforming capital gain into ordinary income (tantamount to the alleged foregone interest) taxable at a higher rate.[15] Section 483 was explicitly designed to preclude that result if the interest

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[13] Respondent's Br. at fn. 4. Respondent also fails to point out that in Technical Advice Memorandum 85-05-005 (Sept. 27, 1984), the IRS held that there was no "related party" exception in section 483 and that it applied for *all* purposes of the Internal Revenue Code.

[14] Respondent's Br. at p. 12.

[15] Petition at pp. 16-18.

rate specified in the installment note was at least equal to the "safe harbor" rate. Furthermore, it is not at all clear that Petitioners even had that option.[16]

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[16] Treas. Reg. § 1.1001-1(g), adopted January 27, 1994, which clearly states that if a debt instrument issued in exchange for property bears adequate interest as prescribed by sections 483 or 1274, the amount realized under section 1001 is the face amount (or "issue price") of the debt instrument.

In summation, Petitioners submit that the decision of the court below could affect countless unsuspecting taxpayers, and that Respondent's Brief camouflages the real issues of proper statutory construction and the impact of that decision on intra-family transactions that Congress intended to protect. We again urge the Court to grant the writ of certiorari.

Respectfully submitted,

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